Responsible Finance Response: The FCA's 'A New Consumer Duty' Consultation

About Responsible Finance

Responsible Finance is the only UK industry association for Community Development Finance Institutions (CDFIs). We believe in a fair financial system where investment flows into communities to create positive economic, social and environmental impact. To enable this we lead a strong responsible finance sector so communities have access to finance to transform lives. Our members make loans in disadvantaged communities that are not adequately served by mainstream financial service providers.

Responsible finance providers are mission driven not-for-profit or asset-locked organisations. They offer affordable credit and support to people who are under-served by mainstream finance providers who may otherwise borrow from high-cost lenders, illegal loan sharks or hard-pressed friends and family. Access to affordable credit improves the wellbeing and resilience of individuals by offering them a tool to smooth fluctuating incomes, cover unexpected calls on their finances, or pay for expected larger expenses such as a new washing machine or the school summer holidays. Alongside this responsible finance providers offer wrap around services such as helping people to claim benefits and providing budgeting advice.

About Our Response

We welcome the opportunity to respond to the consultation on the proposed new Consumer Duty. We consulted with members to inform this paper and are happy to be contacted to provide further detail on any of the points made.

We responded to the questions that we viewed as most pertinent to the responsible finance sector. Because of their structure and mission as community lenders, good consumer outcomes are at the heart of our members' culture, policies, products and processes.

Summary Of Our Response

Responsible Finance welcome's the step-change in consumer outcomes in financial services that the proposed Consumer Duty presents. We particularly like the approach of firms 'putting themselves in their customers shoes'.

Our response provides some practical considerations for the design and scope of the new Consumer Duty as well as highlighting a number of possible unintended consequences. We believe there is a potential within the Duty for firms to set restrictive target markets, enabling them withdraw their products and services from certain groups of consumers, with low-income and vulnerable customers being particularly likely to be negatively impacted.

We welcome the FCA implementing the Consumer Duty in a way which recognises the diversity of the financial services industry and the additional support and guidance some sectors may require. This is particularly true for responsible finance providers who tend to have more limited resource to interpret, implement and embed regulatory change such as this. The sector will need more than 'high-level guidance' to enable it to embed the new Duty.

We do not recommend a 'tick-box' approach to regulation, but a reasonable level of additional support and guidance for community lenders would be appropriate so the Duty does not present a disproportionate regulatory burden to them. This would recognise their vital role in providing services to consumers who are currently not served, or served poorly, by other firms in the financial services market. Specific areas where the responsible finance sector will need additional support are in monitoring, testing and assessing products, processes and target markets; evidencing how outcomes are being achieved; and demonstrating fair price and value.

Consultation Questions

1. **What are your views on the consumer harms that the Consumer Duty would seek to address, and/or the wider context in which it is proposed?**

   The finance sector plays a central role in the lives of all consumers therefore it is vital that the practices causing consumer harm, including those set out in this consultation paper, are addressed by the Financial Conduct Authority. Firms which are not prioritising good outcomes for their customers should be forced to take action to change the way they operate. We believe the Consumer Duty provides a good framework for achieving this if designed appropriately.

2. **What are your views on the proposed structure of the Consumer Duty, with its high-level Principle, Cross-cutting Rules and the Four Outcomes?**

   We feel the proposed structure should prove sufficient to meet the aims of the Duty provided the Four Outcomes contain enough detailed guidance to empower firms to implement and demonstrate change.

3. **Do you agree or have any comments about our intention to apply the Consumer Duty to firms' dealings with retail clients as defined in the FCA Handbook? In the context of regulated activities, are there any other consumers to whom the Duty should relate?**

   Where the proposals will apply to the provision of financial services to SMEs the FCA should ensure it provides specialised detailed guidance on how firms who lend to SMEs can implement it.

4. **Do you agree or have any comments about our intention to apply the Consumer Duty to all firms engaging in regulated activities across the retail distribution chain, including where they do not have a direct customer relationship with the 'end-user' of their product or service?**

   We agree that the Consumer Duty should apply to all firms engaged in regulated activities across the chain regardless of whether they have a direct customer relationship because they will still have an influence on customer outcomes.

5. **What are your views on the options proposed for the drafting of the Consumer Principle? Do you consider there are alternative formulations that would better reflect the strong proactive focus on consumer interests and consumer outcomes we want to achieve?**

   We believe that both options reflect a proactive focus on consumer interests and outcomes and the need for firms to play a more positive role in delivering good outcomes. We particularly welcome going beyond the expectation to simply 'pay due regard' to the interests of consumers to set a higher standard.

We believe the most practical option in terms of implementation is 2, in that firms must 'satisfy themselves that their conduct could reasonably and objectively be said to be in consumers' best interests, and equip them to be able to make decisions in their best interests.'

Regardless of which option is selected as the Principle the FCA must set out clear guidance on its expectations of how far reaching the assessment of customer outcomes by firms should be and how they can clearly demonstrate this. We do not believe the statement that the FCA would 'not expect firms to go beyond what is reasonably expected given the nature of their role and the product or service they offer' provides sufficient clarity for firms to understand how to implement and report on the Duty in relation to customer outcomes.

Whilst we understand the FCA does not view compliance as a 'tick-box exercise' we believe that detailed guidance and clear parameters does not amount to this. Rather it makes clear what firms can do to demonstrate that they are acting in the best interests/to deliver good outcomes for their customers and can report and justify this to the FCA under the defined Principle.

6. **Do you agree that these are the right areas of focus for Cross-cutting Rules which develop and amplify the Consumer Principle's high-level expectations?**

   Yes.

7. **Do you agree with these early-stage indications of what the Cross-cutting Rules should require?**

   Yes.

8. **To what extent would these proposals, in conjunction with our Vulnerability Guidance, enhance firms' focus on appropriate levels of care for vulnerable consumers?**

   See below on target market and financial exclusion (Q:15).

9. **What are your views on whether Principles 6 or 7, and/ or the TCF Outcomes should be disapplied where the Consumer Duty applies? Do you foresee any practical difficulties with either retaining these, or with disapplying them?**

   No comments.

10. **Do you have views on how we should treat existing Handbook material that relates to Principles 6 or 7, in the event that we introduce a Consumer Duty?**

    No comments.

11. **What are your views on the extent to which these proposals, as a whole, would advance the FCA's consumer protection and competition objectives?**

    No comments, please refer to other responses.

12. **Do you agree that what we have proposed amounts to a duty of care? If not, what further measures would be needed? Do you think it should be labelled as a duty of care, and might there be upsides or downsides in doing so?**

    No comments.

13. **What are your views on our proposals for the Communications outcome?**

    We agree with the proposals. For the testing requirement we would expect the FCA to provide detailed sector-specific guidance on where testing would be appropriate and what form it should take.

14. **What impact do you think the proposals would have on consumer outcomes in this area?**

    We think they will have a positive impact.

15. What are your views on our proposals for the Products and Services outcome?

Target market

We agree that as standard firms have a target market and align their distribution strategies to be targeted towards the customers for whom their products are likely to be suitable. There must also be an understanding that some consumers outside of the target market may still apply for firms' products and services and it may not be feasible to prevent this.

Most firms are likely to have a primary audience of customers (largely defined by age, income and assessment of their credit risk) but also secondary audiences who also have occasional need for the product, but in smaller proportions to the primary audience. This is not always detrimental. For example a toy manufacturer may have 4–9-year-olds in mind as its target market for a certain toy, but children over the age of 9 buying it does not present any poor outcomes – they just happen to be in the minority. Customers may prefer working with certain firms for whom they are slightly outside of their target market because they might prefer the customer experience the firm offers or have had a positive past experience with the firm.

On the other hand, a toy may not intended for under 4's because it contains small parts. In this scenario the company should mitigate against under 4's being given the toy. In this context, there is a case that firms should consider who their products definitely are not for – and could potentially be harmed by – and what steps the firm is taking to avoid selling it to them (for responsible finance providers this may be defined by affordability). We believe the key consideration here is in the firm's acquisition strategy and processes being targeted correctly.

Restricting customer access to products

We believe that creating granular definitions of a target market that are reported to the FCA could potentially lead firms to further exclude and under-serve particular groups of consumers. In the example given under 4.40 e. in the consultation paper it suggests that the firm suspends sales of the product and reviews whether it should reposition the target market if customers are making late payments and paying substantial late payment fees. Whilst this seems a common sense approach, it may result in lower-income customers no longer having access to the product, when in fact the product itself should have been redesigned or a new product created for lower-income groups who are struggling to make payments on time. We believe that vulnerable and lower income consumers could be particularly affected by this. The simplest option for firms may be to redraw their target market and withdraw their products from these markets, which may be more expensive and resource intensive to serve and more complex to define and demonstrate good outcomes for. There is nothing in the Consumer Duty proposals which prevents firms redrawing their target market in an exclusionary way.

This would be detrimental to consumer outcomes, particularly at a time when the market of loan products available to these consumers is contracting. A number of payday, rent-to-own and doorstep lenders have left the market in recent years including Brighthouse and most recently Provident. Fair4All Finance currently estimates that 11 million people in the UK struggle to access fair and affordable credit. These people are denied this essential tool which enables them to withstand financial shocks and spread the cost of larger purchases and events.

According to the FCA's Financial Lives survey, in October 2020 9.7 million UK adults expected to borrow from friends and family in the next 6 months. Informal borrowing has been on the rise since 2017, up from 7% of all adults to 10% in 2020. For young adults aged 18-24, 19% borrowed from friends and family, up from 12% in 2017[1]. We believe this is unsustainable.

There is often a significant human cost to families, relationships and dignity, particularly where people borrow from others who are also cash-strapped. Whilst informal loans from friends and family are interest free, there are real costs in terms of consumers having to reciprocate to ensure they can rely on this source in future, even if their own financial situation is insecure. This often means consumers using others' credit cards and catalogue subscriptions as a form of payment. This may affect their own and others' credit scores, and contribute to deepening financial exclusion in low-income communities. The damage this can cause to these individuals' social networks can be detrimental to their wellbeing[2].

Other people who are unable to access credit are being forced to go without, which can mean living without essential appliances and being pushed into hardship[3]. We recommend that more research is done to understand the financial lives of people who are unable to access credit. This would be useful in informing the focus on consumer outcomes and the cost-benefit of access to responsible finance.

We believe that financial services firms, and particularly banks, should be actively compelled to meet the finance needs of all individuals within the communities they serve because of the fact that they take deposits from these communities.

In the context of the Consumer Duty, firms should consider the outcomes experienced by the consumers they leave behind. By requiring firms to specify their target market for products and assessing and monitoring this, it could help to highlight where gaps in provision and 'credit deserts' exist. This could be used to compel mainstream financial institutions including banks to design different products for a wide spectrum of consumers. Currently banks rarely provide loans of less than £1,000 (amounts often needed by lower income groups) and are unable to lend to individuals with lower incomes and more lumpy credit histories. This means these customers are forced to borrow from more unscrupulous high-cost lenders, friends and family, or possibly seek illegal moneylenders, where they are unable to access a community finance provider due to the current scale of the sector and low levels of awareness. We believe that if banks are unable to serve the needs of all their customers then they should be actively compelled by the Government and the Financial Conduct Authority to partner and invest in community lenders (CDFIs and Credit Unions) to scale up the sector, as is the case in the US, in order to meet their obligations to provide good outcomes for all customers.

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[1] Financial Lives 2020: The Impact of Coronavirus.

[2] Biosca, O. et al (2020) Walking a Tightrope: Using Financial Diaries to Investigate Day-to-Day Financial Decisions and the Social Safety Net of the Financially Excluded. Available: https://journals.sagepub.com/doi/10.1177/0002716220921154

[3] Appleyard, L. et al. (2018) Payday Denied: Exploring the Lived Experiences of Declined Payday Loan Applicants.

Additionally, the FCA should establish good practice for when firms leave markets, in order to protect customers in vulnerable circumstances. In the case of the non-standard credit market, where many lenders are folding or halting provision, customers should be provided with better information about fair and affordable alternatives including responsible finance providers. Customers who have come to rely on a high-cost provider who find it has stopped trading may seek out a similar product with similar poor outcomes. Or worse, if they are desperate for money and unaware of alternatives, they may turn to illegal money lending. Instead, these market exits should be a point of opportunity to direct customers to more affordable options.

In this context we believe that when designing the Consumer Duty the FCA should ensure that it seeks to protect provisions of essential products such as credit, so it does not exacerbate financial exclusion in the UK any further. We are happy to work closely with the FCA on how this can be achieved in line with the new Consumer Duty.

For customers who can't afford to borrow, we welcome the Government's development of the No Interest Loans Scheme.

Demonstrating good customer outcomes

Whilst we welcome the Duty shifting focus from purely measuring and testing narrow compliance to a broader set of measures which test good outcomes, we are concerned about how small firms will evidence that their products and services deliver the expected outcomes and how far reaching this expectation will be.

Testing genuine customer outcomes may prove to be complex if clear parameters are not set. It may require access to data and insights that firms are unable to gain access to or it may be prohibitively expensive for them to do so. For example, it may require a lender to measure the impact that a loan has had on a customer's overall financial situation at the end of the loan by also assessing the customer's situation at the beginning prior to the loan being delivered. It may also require the lender to seek to understand what would have happened if the consumer had never taken the loan out in the first place. Not only would this have practical issues and present a heavy burden on firm resource, the customer may not want to provide this kind of detailed information about their lives. It may be more beneficial to measure more narrow but tangible outcomes. The FCA must provide detailed guidance on how firms approach this.

16. **What impact do you think the proposals would have on consumer outcomes in this area?**

See above.

17. **What are your views on our proposals for the Customer Service outcome?**

We believe the proposals for the customer service outcome are positive.

18. **What impact do you think the proposals would have on consumer outcomes in this area?**

We hope the proposals would have a positive impact on consumer outcomes.

19. What are your views on our proposals for the Price and Value outcome?

We welcome the inclusion of fair price and value in the Duty, particularly as we believe lower-income consumers on the whole have been historically over-charged and under-served by the financial services system.

In order to set out a clear and consistent approach to price and value, in its detailed guidance the FCA must expand on how firms can demonstrate in a way that is acceptable to the FCA that the benefits of their products and services are reasonable relative to their price. This may require an investment in research of customer outcomes and additional reporting which could place a disproportionate burden on small community lenders. This would also apply to the expectation that firms should 'actively assess the value of their products and services throughout their life by ongoing monitoring.'

Some lenders, including responsible finance providers, work with retail partners to provide credit for specific item purchases. They would need clarity that price and value pertains only to the provision of credit itself and not the specific products it is used to purchase.

We believe that value for money is most fundamentally derived by executing a knowledgeable exchange between two parties, and that more still needs to be done for consumers to help them compare different products and their eligibility for them across a range of providers. The consultation document states that 'when markets function well, with competition working effectively in consumers' interests, consumers will be able to choose the product or service that represents the best value for them.' For the credit products available to consumers in the sub-prime market this remains difficult due to the exclusion of this marketplace from mainstream price comparison services.

We therefore recommend the creation of a smart loan comparison aggregator site specifically featuring non-profit or asset-locked responsible finance providers and credit unions. This would support the outcome of empowering customers to decide for themselves what constitutes fair price and value by being able to clearly compare providers through a trusted source.

Finally, the FCA should be mindful that product features and services do not become secondary to a focus on price, particularly where a firm may be unsure how quantify the value added to a new product feature that will ultimately benefit its customers.

20. What impact do you think the proposals would have on consumer outcomes in this area?
As above.

21. Do you have views on the PROA that are specific to the proposals for a Consumer Duty?

In order to provide detailed views on the PROA we would need to see the full proposals for the Consumer Duty. We agree that a PROA would focus firms on the importance of providing good consumer outcomes.

22. **To what extent would a future decision to provide, or not provide, a PROA for breaches of the Consumer Duty have an influence on your answers to the other questions in this consultation?**

As above.

23. **To what extent would your firm's existing culture, policies and processes enable it to meet the proposed requirements? What changes do you envisage needing to make, and do you have an early indication of the scale of costs involved?**

We are unable to determine the extent to which responsible finance providers existing policies and processes enable them to meet the proposed requirements and the scale of costs involved in this without further information on the specific technical requirements of the Consumer Duty.

As outlined in previous questions, the parameters of the duty need to specified alongside detailed guidance and support to enable firms to be confident at embedding the Duty into their policies and processes in a clear and tangible way. We urge the FCA to be precise and not leave smaller lenders such as responsible finance providers grappling with how to implement and evidence its compliance with high-level guidance.

The consultation states that 'firms would monitor, test and (where necessary) adapt their practices and processes on an ongoing basis, to satisfy themselves that they are delivering the expected outcomes. Firms would be in a position to provide information and data to the FCA, to evidence the outcomes of their monitoring and testing activity.' The data required by the FCA must also be set out and must be proportionate to the size of the firm and the sector within which it operates, and not create a disproportionate burden on smaller firms with limited staff teams.

24. **[If you have indicated a likely need to make changes] Which elements of the Consumer Duty are most likely to necessitate changes in culture, policies or processes?**

As above. Whilst the culture of responsible finance providers will remain the same as their goal is always to make their customers better off, not worse, they may need to amend their processes and reporting to enable them to report and demonstrate how they are aligned to the outcomes stated under the Duty.

25. **To what extent would the Consumer Duty bring benefits for consumers, individual firms, markets, or for the retail financial services industry as a whole?**

No additional comments.

26. **What unintended consequences might arise from the introduction of a Consumer Duty?**

In addition to the consequences outlined in the questions above, we would urge the FCA to be mindful of the following concerns when designing the Consumer Duty:

- The Duty may place a disproportionate burden on small firms such as responsible finance providers which may be beyond their level of resource.
- The Duty may expect firms to develop and evidence more sophisticated topics such as behaviour biases in order to meet standards of design which may be beyond their financial capabilities.

- It may expect firms to mitigate behavioural bias pre-emptively which could lead to much narrower products being designed, thus excluding large numbers of consumers.

27. **What are your views on the amount of time that would be needed to implement a Consumer Duty following finalisation of the rules? Are there any aspects that would require a longer lead-time?**

This would depend on the level of resource, support and guidance the FCA provides to the responsible finance sector to empower it to implement and embed the new Duty. We would again like to stress the need for detailed guidance and support instead of 'high-level' guidance, and reiterate that this would not amount to a 'tick-box' approach to regulation.